RICHARD RUSSELL'S DOW THEORY LETTERS INCORPORATED

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June 3, 1987 **LETTER 966**

May 22 DJIA 2243.20; PTI 2559; A-D Ratio -7.31
May 29 DJIA 2291.57; PTI 2567; A-D Ratio -6.62

THE MARKET: The problems and discrepancies are building up for Wall Street. The fact is that this market is becoming a technical hodge-podge, and I explain why in a later section entitled "Problems."

Question: Where are we according to Dow Theory? According to Dow Theory, *the peak of a bull market is reached at the point where the two Averages (i.e., D-J Industrials and Transports) record their last confirmed highs.*

Let's examine the recent price action in detail. Here's what happened on the upside: The last confirmed highs for this bull market were recorded on April 6, a day that saw the Dow close at a record 2405.54 and Transports close at a record 961.48. Subsequently, the Transports backed off, then rallied to a still-higher record peak of 976.04 (May 14). Industrials, however, failed to confirm the new Transport high. Thus, it remains for the Industrial Average to prove that the bull market still lives. To do that, Industrials MUST CLOSE ABOVE 2405.54 some time during the period ahead.

All right, here's what happened on the downside: Following the new record Transport high, the two Averages headed sharply lower, and on May 19, the Industrial Average broke below its late-April low of 2230.55. But the Transports refused to confirm on the downside. To confirm, the Transportation Average would have to drop below 908.03. If that occurs, a Dow Theory bear market will be signaled. But "a miss is as good as a mile" in this business, and so far the Transports have missed. Thus, a bear market signal was averted by the refusal of the D-J Transportation Average to break the critical 908.03 level.

So as of this writing the Averages have rendered NO VERDICT as to whether this is still a bull market -- or whether a bear market may have started. Furthermore, there's no way of hurrying the game. The market, in its own good time, will tell us the direction of the primary trend, and it will tell us through the action of the D-J Averages.

I might remind readers that we require BOTH Averages (Industrials and Transports) to penetrate critical points (on a closing basis) before valid conclusions can be drawn. The action of one Average, unconfirmed by the other, is meaningless and often deceptive. Thus, the May 14 all-time high for the Transports (unconfirmed by Industrials) was meaningless and followed by a reversal to the downside. By the same token, the May 19 breakdown by Industrials (unconfirmed by Transports) was meaningless and was followed by a reversal to the upside.

On May 26 a new rally advanced the Dow a near-record 54 points. Two days later, on May 28, the Transportation Average pushed to another record high of 980.70. But by week's end the Dow was still 95 points under its bull market high of 2405.54. (See Late Notes, page 6 for more).

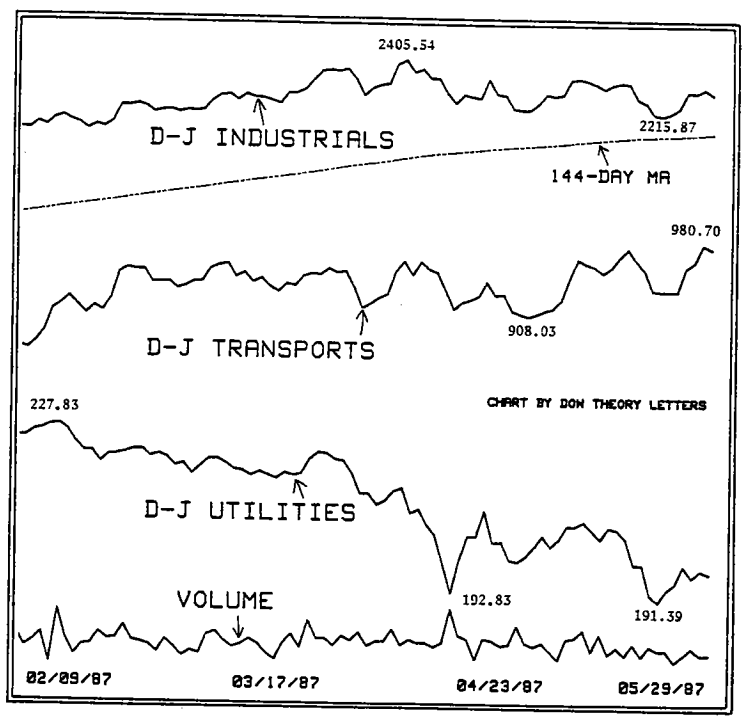
"What of the Utility Average?" I am asked. The Utility Average plays no part in Dow Theory, and that may be just a matter of historical coincidence. The basic tenets of Dow Theory were formulated during the first 20 years of the century, but the Utility Average only came into being in 1929. Thus, the Utilities appeared "too late" and were left out of Dow Theory (although in my opinion they probably should have been included).

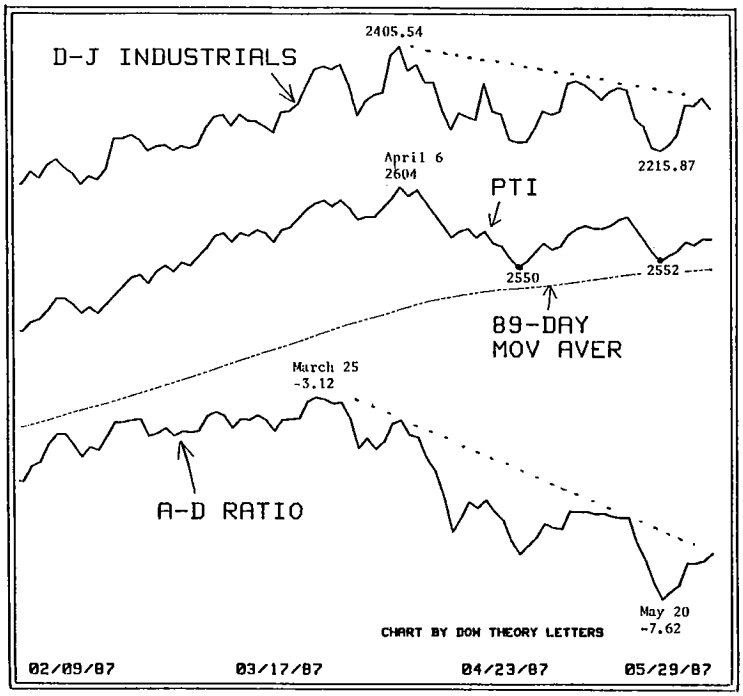
I discuss the Utilities often, because this Average has been a help in identifying the underlying trend of the market. The Utilities are particularly sensitive to interest rates, and many years ago I did a study showing that the stock market will almost always follow a joint trend in both the D-J Utility Average and the D-J 20-Bond Average. That study would hold up very well today.

At any rate, the D-J Utility Average recorded its bull market high on January 22 at 227.83 (almost three months before the peaks in the other Averages). From its January 22 high the Utility Average broke to a low of 191.39 on May 20. Since then Utilities have rallied (although rather sluggishly), and it remains to be seen whether the Utilities can, in the period ahead, better their January high of 227.83. A failure to better 227.83 (although there is no particular time limit) would be a negative influence for the market.

What about the action of my Primary Trend Index? The PTI recorded its bull market high on April 6 at a value of 2604. From there it turned down, hitting a low on April 27 of 2550 (see page 2 chart). A rally then advanced the PTI to 2582 on May 14. But on May 15 the PTI turned down again, touching a May 20 low of 2552 before rallying once again.

The boundaries for the PTI are now clear. A new high above 2604 would obviously be bullish for the market. Conversely, a break below the April 27 low of 2550 would reverse the trend of the PTI to the downside, and such a break would be extremely important and very bearish. In the meantime, the 89-day moving average of the PTI now stands at 2546, so the PTI, as this is written, is still holding ABOVE its moving average.





The action of the PTI, however, is now more tenuous than anything seen in many months. Although I never jump the gun on the PTI, I feel that the action of this indicator does justify my recent cautious policy, a policy which says -- cut back on stock holdings and boost your cash position.

INVESTMENT POSITION: Our one-horned bull remains in the box, reminding us that the weakened bull is still in command. The hardest thing to do in investing (and in writing about investments) is to remain coldly analytical. To have preconceived notions or to live on hopes and wishes is a sure ticket to disaster in this business.

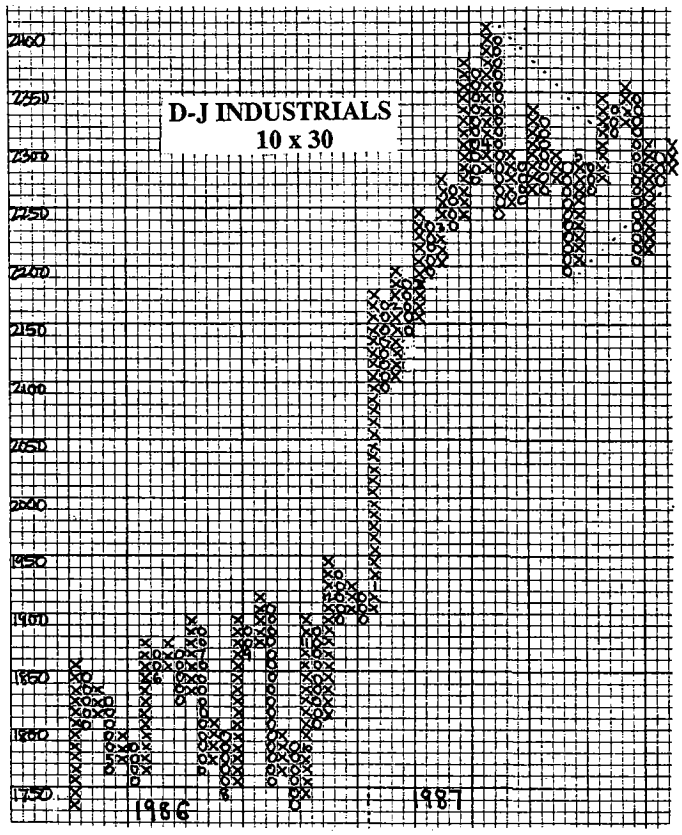
So far, the market action has been ragged but not decisively bearish. I've advised cutting back on stocks and raising cash positions, not on the basis of "a big bear market around the corner" but on the basis of current overvaluation in the stock market.

Because of the current minuscule yields in stocks, my feeling is that the risk/reward ratio for holding a big position in stocks is unattractive. After all, if the Dow rises to say 2800 we're talking about roughly a 15% increase in the blue-chip issues (and not necessarily in a typical portfolio). To me, that's hardly an incentive to be heavily in stocks -- not when tax exempt AA-rated bonds are yielding 8%, and I am collecting less than 2.9% in taxable stock yields.

DOW POINT & FIGURE: Here's an update on the chart which appeared in Letter 964. This is a 10 x 30 P&F chart, which means that each box on the chart equals 10 Dow points, and only rallies or declines of 30 points or more are shown. Thus this chart provides a concentrated but very clear picture of the Dow action since mid-1986.

What this chart depicts is a Dow rise to the 2410 box, a subsequent break down to the 2200 box, a more recent rally back to the 2360 box, and then another drop down to the 2210 box.

The picture is that of a massive "indecision pattern," but the most recent action (i.e., the drop to 2210) gives the formation a somewhat bearish look. It also shows us that there is a good deal of resistance beginning around Dow 2310. And the chart suggests that



it will not be easy for the Dow to get through this overhanging supply. Anything can happen on Wall Street, however, and we must let the market tell its own story.

But I did want to show the rather toppy formation which the Dow has now traced out. On the downside, a Dow break to 2190 or lower would be very bearish. Such a move could easily take the Industrial Average back below 2000 again. On the upside, a move to 2370 by the Dow would be very positive.

PROBLEMS: If I had to adopt a single slogan that would FIT EVERY SITUATION in both life and in the markets it would be this — "Nothing is easy." Well, I take that back. Occasionally in the markets one hits one of those rare periods when everything is going right, everything is in gear, and the direction of the market is absolutely clear. But as I said, those are RARE instances. And unfortunately, today isn't one of those instances.

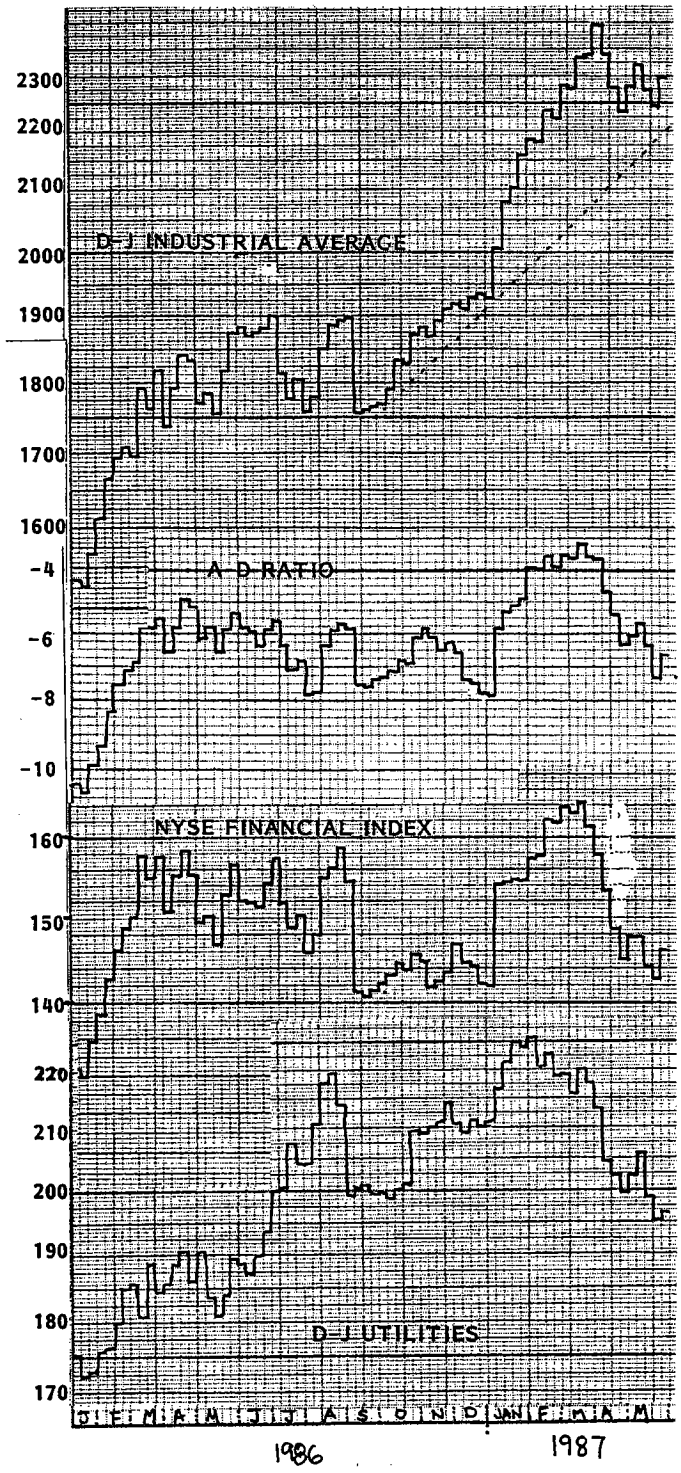
The weekly charts on page 3 tell you why. Here we see the Dow still holding above an important trendline, a trendline that connects two 1986 low points. But the discrepancies in the three other indicators are enormous. First, the A-D ratio (which tracks the advancing or declining tendencies of the majority of issues on the NYSE) is scraping against both its mid-1986 low and its January 1987 low. This tells us that the majority of Big Board issues are now having a HARD TIME.

Next, we see the NYSE Financial index, which includes ALL the financial stocks on the Big Board: Banks, small loan companies, S&Ls, brokerage stocks, fund management companies. This important index has now fallen within a few points of its September 1986 low. Obviously, a sagging trend in the huge financial complex does not constitute a healthy situation for the market.

Finally, we see the chart of the D-J Utility Average and this weekly graph provides more perspective than the page 1 chart. Clearly, the Utilities are in trouble, that Average having broken below important support in the 198-200 area. Many analysts are saying that the Utility Average is merely reflecting the recent tightening in interest rates. Maybe and maybe not. It is always dangerous to write off a move in any average on the basis of the obvious.

What can we conclude from these charts? My own feeling is that the charts are telling us that the market is now confused by too many

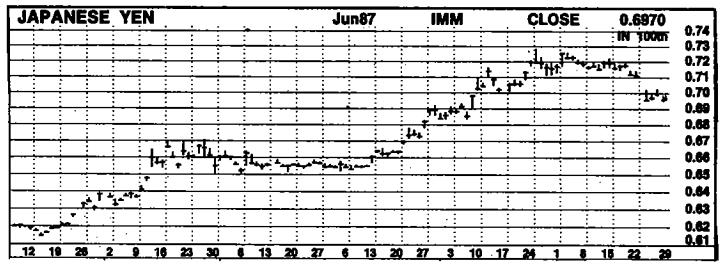
groups going in too many different directions. The peak of strength for the bull market clearly was recorded in March, when peaks were recorded in most of the indices and averages. Since then, it's been a "cross your fingers and hope" kind of market. And as every veteran knows, it's dangerous to depend on hope where Wall Street is concerned.



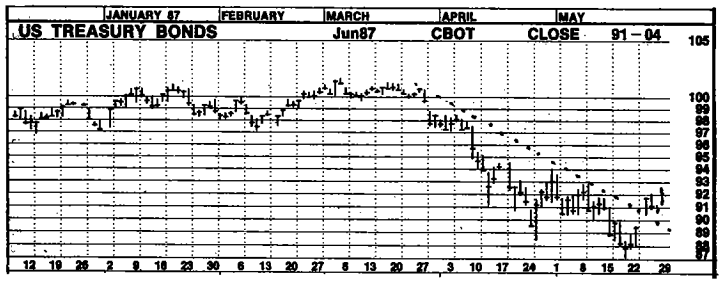
CHARTS: I've been studying charts and reading them for 40 years, and I thought last week could have been a "turning point" week. Here's what I see (daily charts courtesy of Investor's Daily).

This may surprise a lot of readers, but I believe the widely-advertised "inflation blip" is over. I said in previous Letters that the markets are now so sophisticated and super-sensitive (following the 1970-80 experience) that any hint of inflation will send interest rates rocketing higher -- and the higher rates will kill off inflation, pronto. I think that's what we've been seeing, and I believe that's what the markets have been telling us.

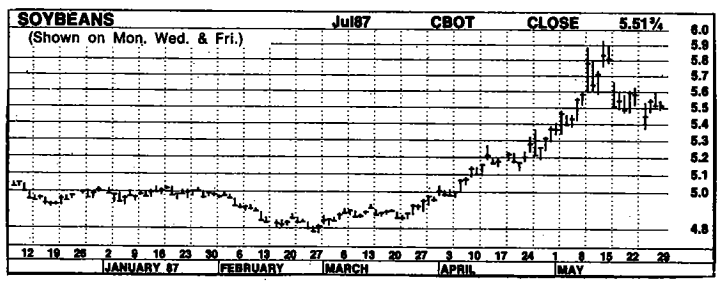
First, the (foreign) currencies look to me as though they've had it. The major currencies gapped down last week, and you can see this action in the yen chart. To put it briefly, I think the dollar is at, or very close to, a bottom, and I think the yen, the mark, and the franc have toppped.



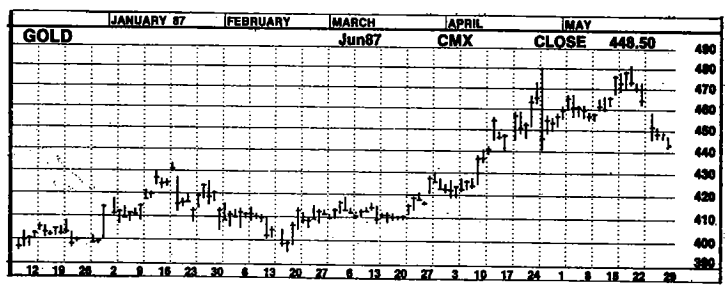
By the same token, I think the bonds are at, or are very close to, a bottom. Last week the T-bonds (futures) gapped above their declining trendline. If you're a bull on bonds, you've got to be impressed with that action.



The grain bull market looks kaput to me. I use soybeans as an example. Corn and wheat don't look much better.



See page 6 for the metals. But the chart of gold suggests that gold is in for some heavy and maybe prolonged consolidation and correcting. In the last few Letters I noted that gold was overbought according to my technical studies. It was -- and is.

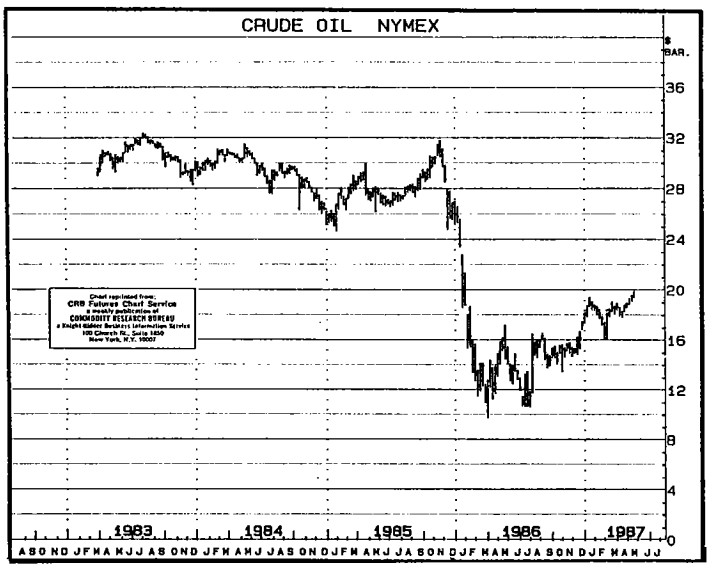


PANIC: The markets (any markets) are seldom surprised by shocking events. But during those rare instances when the market is caught by surprise a panic may result. My own definition of a panic is this: *A panic is a collapse (triggered by fear and unforeseen circumstances) which causes the price of the item to fall precipitously within a short span of time.* That's a loose definition but it will do.

We've had a few panic declines in the markets over the last two or three years. Panics are particularly interesting for one reason. The reason is this: The SUREST ACTION in the markets is the recovery following a panic. It is almost a rule (if anything in the markets can be called a rule) that following a panic, there will be an advance that will recover roughly one-half of the price lost during the panic. This applies to individual stocks, to commodities, to indices, and to averages.

For example, gold and precious metals went into a panic decline during 1980. As I remember, silver was subject to an unbelievable eleven "limits down" on the commodity exchange. Another panic example: crude oil collapsed in a panic decline during late-1985 and early-1986. A third more recent example: over the last few months bonds have seen panic action with many bonds losing 8% to 12% of their value in a matter of weeks.

In order to illustrate panic action, I am including this chart of crude oil (futures). Here we see the shocking collapse from a price of $32 a barrel in late-1985 to an early '86 low of under $10. This sudden panic resulted in a loss of roughly $22 a barrel.



Figuring a loss of $22 on panic, the halfway recovery level from just under $10 would be about $21. As this is written crude has already recovered to within about $1 of the "normal" expected halfway recovery point. Of course, the immediate question arises: "Are we witnessing a new bull market in crude, or is this rise to near 20 simply the expected minimum 50% recovery?" And the answer is that no one knows, and at this point no one can know.

However, what I will watch for is any rise in crude that recoups MORE THAN 50% of the value lost during the panic. Thus, if crude rises to say $23 or better, the action will appear to be of the bull market variety. Furthermore, if crude rises to $23 I would say that there is a good chance that it will continue pushing up and in due time I would even expect crude oil to attack its old high of 32.

This same line of reasoning, of course, applies to gold (see page 6 of the last Letter). And it also applies to bonds. From wherever the bonds bottom out following the April-May panic, we can expect a recovery which will serve to recoup at least half of the ground lost.

Thus, somewhere ahead there will be a very profitable play in bonds. But first we have to see at what point the bond market becomes "sold out" and at what point a major bond bottom is formed. That could occur in a week or a month or it may have already occurred (personally, I vote for the latter). But one thing is sure. When the inevitable bond market rally arrives, it will surprise everyone with its strength. Investors fail to realize that after panics come recoveries. In fact, some of the best and surest money is made during the inevitable recoveries that follow panic declines.

WHAT'S CHANGED? I guess as I get older I do more mulling and pondering. And I often wonder whether we are living out our lives and our times in the form of a huge morality play. I find myself thinking about that a lot. And I remember scenes of the past; I remember former decades, I remember my youth and my childhood, and I wonder whether somehow, someday, I might be able to make crystal-clear sense out of it.

For instance, I remember Manhattan when I was a boy during the 1930s. I remember the Depression, and the long lines of tired men waiting outside the employment offices. I remember Romeo's Spaghetti House on Broadway at 46th Street where you could get a huge plate of spaghetti for 25 cents (with two meatballs 35 cents). And gad how I loved that spaghetti! I remember the Broadway Danceteria where you could take your girl and eat and dance -- all for a dollar. I remember the 1939 World's Fair with all its exotic visions of the future and its gaudy excitement and also its seedy sideshows and vendors and it's fabulous Billy Rose Aquacade. (featuring dozens of precision-swimming bathing beauties). I remember the Pennsylvania Hotel where I could listen to Glen Miller, dance the night away, and do it all for $2.15 ($1.50 cover charge for you and your girl and 65 cents for a big pitcher of beer). I remember my years in junior high when my parents would give me 35 cents for lunch (with that I could buy a triple decker sandwich and a "Broadway soda" which was vanilla with two big scoops of chocolate ice cream).

I remember that when I was 16 and still in high school (1940) I tried to get a summer job, any kind of a job. I searched for a full month, and finally a buddy told me that he was working as a packer and a loader at G.W. Button Co. in Harlem, and "Yeah, they might need one more worker." I immediately applied for the job, which entailed loading trucks eight hours a day five days a week plus Saturdays 8AM to 1PM. The pay was $18.75 a week (and it was a union job at that). I was thrilled to get the job and rushed home to tell my parents that I had found work, and "at better than $18 a week!" And I remember an American Youth Hostel trip to California in 1939. The fruit was rotting on the ground and there were signs saying, "Pick all you want for 25¢." And I remember seeing the 1939 San Francisco World's Fair, and the scene that sticks most in my mind (blush) was Sally Rand doing her famous fan dance.

I also remember my mastoid operation, which occurred when I was 8 years old back in 1932. I very nearly died during the operation. Today with a few shots of penicillin that deadly infection would be knocked out in no time, and the fact is that most doctors today have never even witnessed a mastoidectemy.

I remember being able to see any Broadway show on a matinee afternoon for $1.10 and sometimes for 55 cents. I remember seeing Frank Sinatra with Tommy Dorsey's band at the Paramount together with a first run movie all for 75 cents -- $1.10 after 12 noon. I remember seeing the crazy wrestling matches at St. Nicholas Arena with champion Jim Londos matched against the dreaded "Strangler" Lewis. And I remember the Depression tin-can shacks in Central Park (they called them "Hoovervilles") where whole families lived, trying to make it through the bad times of the '30s.

I remember the good things and the bad things, and I try to make sense out of it all. And I find myself wondering whether the world is any better off today than it was back in the '30s and '40s and if so where and how.

I believe there is much more immorality today than there was 50 years ago. In 1937 you never heard of anyone hitting a cop. You never heard of mass teenage pregnancy or gun-toting youth gangs, and almost all of the boys and girls I knew were virgins with a capital V. And as far as dope, it was almost unheard of except among a few jazz musicians.

Where have we progressed? To me it's very obvious. Today we have vastly more knowledge than we had back in the "good old days." We just know a lot more. We may not use 5% of what we know, but we know more and we have access to more. The

sources of information and knowledge today absolutely dwarf the resources of 20 or 25 years ago.

That I think is probably the greatest difference between today and when I was a boy. To me it's as if the powers above have given us the knowledge, the information, the ACCESS to the information. And the powers are gazing down at the world below and saying, "Here, it's up to you. Use it for good, use it for progress -- or destroy yourself in your stupidity and greed and arrogance."

I disagree with the people who talk about the "good old days." Frankly, I couldn't wait for the '40s and '50s to be over. To me, those were the prejudiced days, the dark days, the uninformed days, the difficult days. I remember a friend telling me, "Back in 1939 it only cost a nickel to ride the trolley. The only thing is that back in '39 I didn't have a nickel." That's the way I feel about my life and times back in the dark days. Life may be costly today, there may be more immorality today, the debts may be obscene today, but I'll take 1987. I think we've made some progress.

NOTES & QUOTES: Personally, I was never enamored of franchises, but look what's happening. Franchises in the US currently do about $500 billion in business, and by 2005 it is estimated that they will do $1 trillion (which will amount to fully half of all retail sales.) One attraction of franchises -- over half of all small independent businesses go belly up in the first five years, but only 10% of franchises go to the wall in the same period.

What are the current hottest (fastest growing) franchises? (1) Domino's Pizza with 1,970 outlets. Start-up costs are $79,000 to $135,000 with a royalty fee of 5% and advertising fees of 3%. (2) McDonald's with 6,150 outlets. Start-up costs are around $325,000 with 11.5% royalty fee and an additional 4% for advertising. (3) Burger King with 3,555 outlets. Royalty fee is 3.5% plus 4% for advertising. (4) Jazzercise with 3,073 outlets. Royalty fee is 30% and no extra for advertising.

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Everyone has gasped at Lee Iacocca's near-$21 million 1986 take from Chrysler, but few have noticed that Lee recently sold 150,000 shares of Chrysler and intends to sell 300,000 more. What does all his selling mean? Well, either Lee is skeptical about the auto firm's future or he simply wants to raise cash. If any of my subscribers know Iacocca, please ask him for me.

* *

Inc. magazine lists the following cities as tops in the nation in terms of rate of job generation, rate of new business start-ups and percentage of thriving young companies. (1) Austin, TX, (2) Orlando, FL, (3) Phoenix, AZ, (4) Dallas-Ft. Worth, (5) Tucson, AZ, (6) San Antonio, TX.

* *

Sport magazine runs an annual list of the highest paid athletes. In 1983 only 23 of the top 100 were paid $1 million or more a year. This year all 100 made more than $1 million. Of these, 61 were baseball players, 19 basketballers, eight boxers, three football players, and four tennis players.

Speaking of sports, I'll predict that Walter Peyton will be the first black owner of an NFL franchise. He can easily raise the money, he's loved by everyone, he's a fabled athlete, and the time is right (plus the fact that it would be a huge public relations coup for the NFL). Walter is already talking to Rozelle about it. He'll get it.

* *

The June 2 issue of National Enquirer shows a color cover photo of Gary Hart with Donna Rice sitting in his lap with her arm around him. I mean, can you believe the chutzpah (or stupidity) of this guy. And he was running for president!

* *

I'm all for globalization, but gad, can you believe that the British (F.H. Tomkins of London) have just bought Smith & Wesson. S & W has been supplying weapons to red-blooded Americans for 135 years. What'll they do next -- sell the Statue of Liberty to Liechtenstein?

* *

I've been watching CopyTele stock (OTC) for a long time. A huge short position of 1 million shares has been built up against a total of 8.8 million shares outstanding and many skeptics obviously believe the stock's a joke. The company has built a prototype for a flat-panel display TV screen. My very bright friend, Charlie Maxwell (C.J. Lawrence), has bought 400,000 shares of the stock for his clients, and he thinks COPY actually has the technology for the long-wished-for flat screen. But Charlie also believes COPY will need a big firm to sponsor its production. Is COPY a joke or a gem? Time will tell.

* *

Do great golfers live forever? This year Sam Snead (he still competes), Byron Nelson, and Ben Hogan will all be 75.

* *

Comedian Mort Sahl when asked last week whether there are any true liberals left: "Not really. They're really social democrats in the European sense. No, there are no real liberals. Gene McCarthy's a liberal and John Kennedy was, and William O. Douglas was, but not these guys. They're humorless for one thing. Ralph Nader is totally humorless. He's probably done more to destroy capitalism than Lenin. I mean, the comedians are all liberals. I never met a right-wing comedian. Too bad. There ought to be people of every stripe doing comedy."

* *

Statistics: The audit rate for all tax returns during 1986 was 1.14% -- down from 2.5% 10 years ago ... In 1985 (latest statistic), one-fifth of all Americans moved to a different location. One-third of these settled in a new county or state.

* *

Where do all the crazies in Southern California go to have fun? Why guess. Here are the attendance statistics for 1986: Disneyland in Anaheim 10 million attendance; Knott's Berry Farm in Buena Park 5 mil; Calif. Museum of Science and Industry in LA (believe it or not) 4.9 mil; Universal Studios 4 mil; San Diego Zoo 3.3 mil (with another 1.2 mil to the San Diego Zoo's Wild Animal Park), and San Diego's Sea World 3.1 mil.

* *

NYC long ago ran out of space. That's why they build skyscrapers in Gotham. If you can't pack 'em in horizontally, you can pack 'em in vertically. In fact, a leading athletic club in the City is called "The Vertical Club." Now there's another and newer way to jam-pack the City. Since Manhattan is an island, why not just build over the water? And that's what's happening. At least three huge new projects will be built partly over water, the Hudson River Center (12 acres over water), Battery Park City (46 acres over water), and East River Landing (to be built on a 23-acre over-water platform).

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One of my high school classmates and buddies was Don Morris. Don, an Annapolis graduate and a leading historian, now writes for the Houston Post. In a recent column he outlines the Russian long-range plan for world domination. (1) Disarmament program: Every Soviet diplomat and propaganda tool is aimed at disarming the West. (2) "National Liberation Movements": Every violent dissident group that might help unsettle a democratic or authoritarian regime is backed to the hilt by the Soviets. (3) Propaganda wars coordinated with liberation movements are mounted on rightest targets such as Batista, Somoza, Marcos, the Shah, Haile Selassie, etc. (4) Isolate the West from its mineral and petroleum sources, with the prime targets for Soviet domination being the Persian Gulf, the Saudi Peninsula and Southern Africa. (5) Control of the S. Atlantic and Indian Oceans to control approaches to the Persian Gulf. (6) Make the Soviets a major influence in Central America (bases now in Cuba and Nicaragua) with the ultimate goal a Communist takeover of Mexico. (7) Weaken the NATO alliance by every means possible. (8) Contribute to America's economic woes, mainly by driving up the cost of energy.

Summarizes Morris: "The strategy is firm, constant and continual: the tactics are flexible and tailored to the day -- anything that contributes is instantly used. There have been setbacks: China, Chile, Portugal, Somalia. But some 40 countries have fallen since 1945, and we still haven't learned how to stop Russia. It will take more than vague yearnings for peace and human rights."

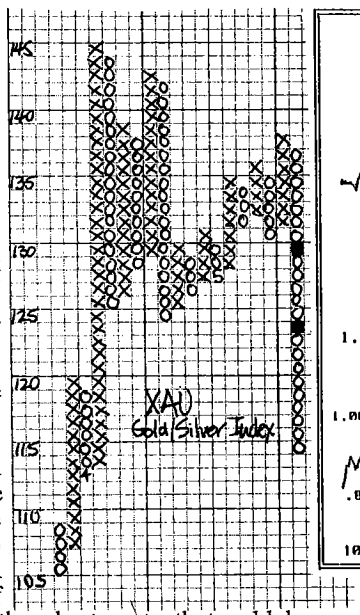
* *

GOLD, PRECIOUS METALS: As I see it, there are three major differences between the precious metals bull market of the 1970s and the precious metals bull market of today. Here they are:

(1) Today the general public is very familiar with gold. There are numerous gold coins to pick from, and the public remembers what happened to gold and gold items during 1975-80. In other words, gold has the benefit of public memory and public relations today.

(2) In this precious metals bull market, the US government is on the side of the gold holder. After all, it is now LEGAL for US citizens to hold gold, you can even hold gold in an IRA, and today the US is producing gold coins for its citizens to buy. This is a far cry from the 1970s when our government was stupidly denigrating anything remotely related to gold.

(3) This precious metals bull market, in my opinion, is not based on inflation; it is based on the possibility of a collapse in the world banking system or the world debt structure or the global financial system. None of that may occur, of course, but to ignore the possibilities is to be in never-never land. Thus, the global move to gold as insurance. Gold insurance -- true insurance -- seems to me to lie in gold coins rather than gold shares.



The gold/silver index (XAU) flashed a sell signal via point & figure analysis when it touched the 130 level (higher solid black box on the P & F chart). A second sell signal was given when XAU hit 124 (lower solid black box on the P & F chart). That the gold and silver stocks are correcting can hardly come as a shock to my readers. In recent Letters I showed that the XAU had increased almost 150% from its 1986 low and that precious metal stocks were sporting bloated P/E ratios of anywhere from 30 to 75.

Meanwhile, the action of the gold (the metal) has been much more conservative. But here too (see gold section of the last two Letters) we had a case of an item being overbought and in need of corrective action. Turning to the chart, note that gold has a consistent habit of bouncing above and below its 144-day moving average (MA). In bull markets the price tends to bounce far above the MA (this produces the overbought condition on the momentum index), following which gold always seems to sink back to its MA.

Last month gold advanced to a peak of 475.25, a level which took the metal about 50 points above its MA. The action also pushed the momentum index into the overbought zone. That's the reason for the corrective action since. Note that the momentum index is now near the middle of its range -- in the neutral zone.

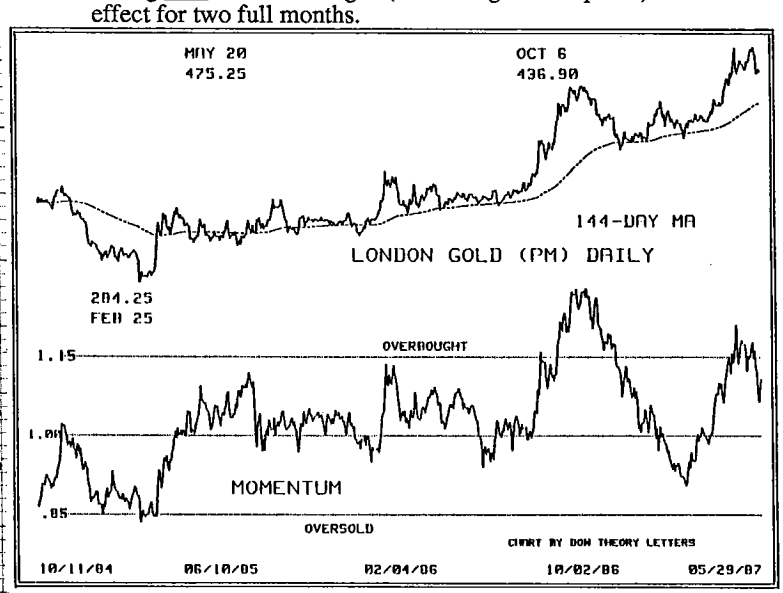
However, gold is still roughly 25 points above its MA, with the MA now standing at 422. Therefore, it would not be surprising if gold came down to the 422 level or even slightly below. But I believe that the gold bull market is still in force. Therefore, the corrective action we are now witnessing should be viewed as both healthy and constructive for the precious metals.

The picture for gold and silver stocks is somewhat different. The XAU index (which is composed of half gold and half silver stocks) rose from 74 to 144 without anything resembling a correction. Consequently, it would not surprise me if this index corrected back to around 100. Such a drop would represent a drop of perhaps 20% in the average gold or silver share.

People forget that what prolongs a bull market, any kind of bull market, is the phenomenon known as the correction. A rocket-rise type of bull market, one with little or no corrective action, always ends up as a SHORT bull market. Thus, seasoned investors tend to welcome corrective action during bull markets. They know that the more corrections and the longer and more often a bull market is held back, the bigger that bull market will be -- and ultimately the HIGHER that bull market is fated to climb. Of course, the same thing is true (but in reverse) during bear markets.

LATE NOTES: A few subscribers have asked me why I haven't been recommending stocks to buy. My answer is that I recommend stocks to buy when I think stocks are in a buy zone or when I believe a particular stock is worth buying. At present, I do not think stocks are in a buy zone, nor am I enamored of any particular issue. I must say, however, that I am impressed with the performance of one fairly new closed-end fund, the Gabelli Fund (GF on the NYSE), a fund which is now selling at a discount of 15% from net assets.

On May 28 the D-J Transportation Average closed at 980.70. This was the second new high in the Transports, a high set against two lower peaks in the Industrial Average (see page 1 chart). Thus the divergence in the Averages (which began on April 6) has been in effect for two full months.



Divergence in the Averages (*i.e., periods in which the two Averages travel in opposite directions*) is usually a negative sign. In the past, divergence has tended to be an indication of distribution.

Ultimately, the two Averages will get in gear either on the upside or the downside. History shows that the two Averages will not travel on separate paths for too long. For an "all clear" signal and a reconfirmation of the bull market, it will be necessary for Industrials to better their April 6 high of 2404.54. On the other hand, if both Averages turn down and the Transports were to break below their April 28 low point of 908.03, a bear market would be signaled.

The advance-decline ratio is now down to a level where it has wiped out most of its gains for 1987. This is not a very happy omen for the market. I say that because even if the Dow were to better its April 6 high of 2405.54, the odds suggest that the A-D ratio would not confirm (the A-D ratio just has too far to go on the upside).

Thus, the market through divergence in the Averages and through poor A-D action has put itself in a difficult technical situation. My own opinion, based on overvaluation in the market (which I have discussed repeatedly) and based on the current technical situation is that the market faces either an extended trading range or some unpleasant downside action. One of my technical studies, in fact, indicates that the the odds are THREE TO ONE that this market will be under heavy selling pressure sometime between now and September 1.